

for distributing content within their systems¹²⁶ and because of the proximity of such neighboring systems as AT&T/Cablevision and TimeWarner/MediaOne. An elimination of such potential competition should not be allowed.

III. THE MERGER WOULD CAUSE SUBSTANTIAL FORECLOSURE OF COMPETITION IN RELATED BROADBAND MARKETS

The combination of firms controlling an overwhelming share of broadband access today, even if those firms would not be competing with one another, creates a classic problem of foreclosure for firms vertically related to the broadband access market. The key facts are that AT&T's share of residential subscribers to broadband services in the United States would grow from 40 percent to 57 percent and that @Home and Road Runner together would serve 80% of all current residential subscribers to broadband transport. The result would be a classic foreclosure problem with AT&T, effectively monopolizing a resource needed as an "input" by a number of vertically related markets.¹²⁷

This problem cannot be sidestepped by pointing to the possibility that current dominance of cable broadband transport may be dissipated over time by other technologies. Such an argument is ordinarily insufficient in merger analysis and is suspect on its face — especially in a

¹²⁶ See Sara Robinson, *Multimedia Transmissions are Driving Internet Toward Gridlock*, N.Y. Times, Aug. 23, 1999, at C1.

¹²⁷ *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 45-47 (1984) (O'Connor, J., concurring in the judgment); *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589, 595-96 (1st Cir. 1993) (per Boudin, J.); *Barry Wright Corp. v. ITT Grinnell Corp.*, 727 F.2d 227, 236-37 (1st Cir. 1983) (per Breyer, J.) (recognizing that "a three-year 'foreclosure' of 50 percent of the relevant market . . . sounds like a significant foreclosure") (citing *Standard Oil Co. v. United States*, 337 U.S. 293 (1949); *Lessig v. Tidewater Oil Co.*, 327 F.2d 459, 468 (9th Cir.), cert. denied, 377 U.S. 993 (1964); *Mytinger & Casselberry, Inc. v. FTC*, 301 F.2d 534 (D.C. Cir. 1962)); D. Melamed, *Exclusionary Vertical Agreements* (Apr. 2, 1998) <<http://www.usdoj.gov/atr/public/speeches/1623.htm>>.

setting where (unlike with the Clayton Act) the burden is on the merging parties — for the argument seeks to explain away a demonstrable current problem by hypothesizing some future, merely wished-for solution.¹²⁸ The evidence of current market facts do not allow applicants to carry their burden. Wireless broadband is off in the distance as a widely available service for residential users, as far as any record evidence indicates, and cannot be seriously relied on by applicants. Only DSL service from telephone companies warrants discussion, yet it cannot play the role that applicants have assigned to it.

From a technical perspective, DSL, provided over telephone company loops, is the one, serious competitive alternative to cable today. Technologically, however, there are significant limits on the near-term availability of the service for a large number of consumers who will have a choice of cable or nothing for broadband transport; for all such customers, cable is the bottleneck through which other broadband-dependent firms must pass. In addition, the current regulatory environment is a disincentive to serious, head-to-head competition from DSL. With regulation so sharply out of balance, telephone-company DSL cannot currently be ranked as a competitive force capable of effectively disciplining the AT&T/MediaOne conglomerate.

To begin with, the Bell companies are excluded entirely from the core backbone market. AT&T (*i.e.*, cable) has the most extensive and capacious long-distance network in the country. If backbone markets were fully competitive with plenty of capacity to spare, this might not matter very much. But they are in fact highly congested and far from fully competitive.¹²⁹ The Bell companies rank among the few companies with sufficient resources and expertise to enter the

¹²⁸ See Gertner Declaration, *supra* note 90, ¶ 14.

¹²⁹ See Robinson, *supra* note 126 (describing network congestion).

markets aggressively and to deploy new capacity quickly. Telephone companies should be playing integral roles in the effort to expand backbone capacity. They have the technology, workforce, and financial resources; the main impediments they face are regulatory.

Bell companies face further limits on their participation in other, adjacent markets. They may distribute, but may not manufacture, equipment used on customer premises.¹³⁰ They are therefore limited in how closely they may collaborate with equipment vendors, and have not bought equity stakes in them, as AT&T has done with General Instruments.¹³¹ A second body of regulation excludes Bell companies themselves from providing Internet search engines or content of any kind.¹³² Bell companies are required to set up fully separate subsidiaries for that purpose.

A likely upshot of the mandated unbundling together with TELRIC pricing is that local carriers can hope to recover only their original costs on new, risky investment in facilities and services that turn out to be very popular. New, risky investments that fail, by contrast, are charged to their shareholders, through the vehicle of price-cap regulation. The more advanced

¹³⁰ 47 U.S.C. § 273(a).

¹³¹ One possible result: equipment manufacturers have had difficulty agreeing on DSL technical standards. D.H. Leibowitz et al., Donaldson, Lufkin & Jenrette Securities, Investext Rpt. No. 2771430, Media and Entertainment — Industry Report at *19 (Sept. 23, 1998). AT&T/Lucent developed one standard, Carrierless Amplitude/Phase Modulation ("CAP"). As of December 1996, 90 percent of all deployed ADSL hardware was based on that standard, and "most ADSL trials have used CAP technology." Alan Stewart, *The Battle for Bandwidth*, Comm. News, May 1997, at 36. But several bodies favor a different one, Discrete Multitone ("DMT"). *ADSL*, Edge, May 9, 1997; Anne Knowles, *Incompatible ADSL Standards Duke It Out*, InfoWorld, Dec. 23/30, 1996, at TW1. See also J. P. Parmelee et al., Credit Suisse First Boston Corporation, Investext Rpt. No. 2809325, Telecom Equipment/Wireline Quarterly — Industry Report, at *26 (Nov. 30, 1998) ("[D]espite significant rhetoric regarding aggressive service plans, the fact that standards for ADSL are still evolving is likely to slow deployments.").

¹³² 47 U.S.C. § 274(a).

the technology deployed, the greater the regulatory risk, because in such circumstances further technological advance is least likely to deliver the instant, ongoing improvements in performance and declines in price that the Commission might presume into existence indefinitely into the future.

This is not just the Bell companies' view: AT&T has said all this itself, in vehemently objecting to proposals to put cable on the same regulatory footing as telephone companies. According to AT&T's Chairman, "It's not fair. It's not right. Worse, it would inhibit industry growth and competition. No company will invest billions of dollars to become a facilities-based broadband services provider if competitors who have not invested a penny of capital nor taken an ounce of risk can come along and get a free ride on the investments and risks of others."¹³³ "[T]he last thing that government should do," echoes AT&T's Senior Vice President, "is create uncertainty that would have a chilling effect on, and perhaps even retard, these investments."¹³⁴

This regulatory imbalance significantly affects the impact of the proposed AT&T-MediaOne merger. If they faced a comparable regulatory environment, the Bell companies might well be in a position to limit the anti-competitive harms presented by the union of AT&T and MediaOne. But that is simply not the case today. As a result, this merger is likely to have significant and harmful effects on a variety of markets both upstream and downstream from the cable network. In particular, this merger would position the combined company to dominate the

¹³³ C. Michael Armstrong, Chairman and CEO, AT&T, *Telecom and Cable TV: Shared Prospects for the Communications Future*, Statement Before the Washington Metropolitan Cable Club, Washington, D.C. (Nov. 2, 1998).

¹³⁴ Statement of James Cicconi, General Counsel-Executive Vice President, AT&T, *quoted in MCI Restarts Marketing Local Residential Service in N.Y.*, Comm. Daily, Feb. 4, 1999.

markets for broadband portal services, streaming software and video programming, IP telephony, and broadband equipment and software.

A. The Market for Broadband Portals

Broadband portal services, which, among other things, provide the first-screen access to the Internet for subscribers to broadband transport, is a separate market.¹³⁵ The economic significance of portals — which plainly find it efficient to operate and to sell advertising nationally — is confirmed by the rapid growth into multibillion dollar companies not only of AOL but of Yahoo!, Excite, and Lycos. This value is based in substantial part on their unique ability to gather customer-specific information for use in targeted advertising.¹³⁶ The ability of consumers to click through to other web sites obviously does not deprive the portal of its value as entry point, home page, and advertising medium. TCI Chairman John Malone refers to the portals that AT&T/TCI would control as a “walled garden” to which the cable company would govern access.¹³⁷

¹³⁵ A “portal” aggregates and indexes Web content and constitute “gateways” to that content. In the world of high-speed access, portals have been likened to TV networks, such as ABC or CBS, in that they aggregate and provide access to various types of programming. Peggy O’Neill of Dataquest states, “Think of the opportunity if you could be there at the dawn of ABC or NBC . . . That’s what investors are seeing when they buy into these portals. They believe they’re going to become the big networks of the Internet.” Matt Beer, *Portals of Profits; Advertisers Drool at Chance to Aim Their Messages Precisely*, S.F. Examiner, Jan. 20, 1999, at C1. Portals also sell advertising on their sites, often tailoring an advertiser’s message to an individual or group of users. Matt Beer, *Portal Web Sites Help Break Shoppers’ Impulse Barrier*, Star Tribune (Minneapolis-St. Paul), Jan. 31, 1999, at 6D.

¹³⁶ Apparently, @Home already charges “significantly more for ads than its competitors.” Corey Grice, *Road Runner Beefs Up Advertising Push*, CNET News.com (Aug. 4, 1999) <<http://www.news.com/News/Item/0,4,40120,00.html>>.

¹³⁷ D.S. Shapiro, Deutsche Bank Research, Investext Rpt. No. 2783084, Cable & Satellite Newsletter — Industry Report, at *2 (Oct. 19, 1998).

In the broadband portal services market, the AT&T/MediaOne merger clearly raises the prospect of foreclosure. AT&T's subscribers, to obtain broadband access, are required to take the @Home portal, thus locking up 40 percent of the *current* broadband subscribership. MediaOne's broadband subscribers (like those of Time Warner) use Road Runner as their exclusive portal. And "clicking through" is a particularly inadequate substitute for direct portal access for broadband-specific content, because indirect connections to distant servers, as opposed to local servers where content can be cached and directly reached without numerous intermediate hops, can easily defeat the speed of access required for such content.¹³⁸

AT&T's direct share of broadband subscribers would be substantially increased by the MediaOne acquisition — from 40 percent to at least 57 percent.¹³⁹ These exclusive portal arrangements between @Home and cable operators extend for at least another three years,¹⁴⁰ and barriers to entry into the broadband transport market are significant. The shares of foreclosed customers, therefore, are substantial. The effect would be a lessening of investment by other portal providers in the services that make broadband access attractive. That diminution in the competitive state of the broadband portals market would harm not only consumers who buy

¹³⁸ See *infra* Part III.B.

¹³⁹ This percentage is derived by adding the total number of @Home subscribers (260,000 as of the end of the first quarter 1999) to the total number of Road Runner subscribers over MediaOne's cable network (109,000). Of course, AT&T's purchase of MediaOne also means that it will obtain a 50-percent controlling interest in Road Runner. If we assume that AT&T effectively controls Road Runner, AT&T's share of broadband Internet access subscribers reaches 80 percent. See sources cited at *supra* note 117.

¹⁴⁰ See At Home Corp., 1997 Form 10-Q, at 8-9 (SEC filed Nov. 14, 1997) (indicating that exclusivity obligations in favor of @Home with Cablevision, CSC Parent Corp., Comcast, Cox, Kleiner, Perkins, Caufield & Byers and TCI expire in June 2002).

broadband transport over cable wires. It would also harm the other access providers, such as local exchange carriers offering DSL, who depend on a vibrant portal services market to sell their competing broadband transport. As a result, competition would be harmed in the transport market itself.

The exclusivity of portal/transport arrangements that creates this anticompetitive harm is, of course, anything but inevitable.¹⁴¹ Local exchange carriers provide competing service providers with equal access to *their* transport services. Several small cable operators in this country provide cable modem service without the exclusivity of @Home, Road Runner, or their own portal, allowing competing providers to use the broadband transport.¹⁴² Recently, GTE and AOL completed a two-month trial in Florida, and both AOL and CompuServe were allowed to

¹⁴¹ Indeed, non-exclusivity has been mandated in Canada. *See* Telecom Decision CRTC 98-9, *supra* note 105, ¶ 77 (finding that cable operators who offer high-speed Internet services must offer those services to independent ISPs on a tariffed basis).

¹⁴² Knology, for example, is a cable overbuilder operating in the Southeastern United States. It provides a high-speed Internet access service called OLOBAHN over its own cable lines. Knology, *Knology Internet*, <<http://www.knology.com>>. In September 1998, Knology signed an agreement with another broadband Internet access provider named MindSpring. MindSpring had approximately 1,228,000 customers at the end of the second quarter, up from 1,157,000 at the end of the prior quarter. MindSpring News Release, *MindSpring Announces Second Quarter Results and Accelerated Growth Initiative* (July 27, 1999) <<http://www.mindspring.net/aboutus/press-releases/1999/0727.html>>. Knology's cable customers thus have a choice between MindSpring's Internet service and Knology's own offering. A handful of other cable operators are doing the same. Charter Cable, has an agreement with EarthLink, an unaffiliated ISP, that allows EarthLink to provide high-speed transport across Charter's network to EarthLink end users.

link into GTE's cable networks.¹⁴³ The trials gave consumers the ability to sign up for AOL directly over cable networks without first going through GTE's ISP subsidiary.¹⁴⁴

Exclusivity, however, is the hallmark of this merger. The combination of AT&T and MediaOne threatens to eliminate everyone other than @Home and Road Runner from the broadband portals market. This is not in the public interest, and the Commission must not permit it.

B. The Markets for Streaming Software and Video Programming

The proposed merger also creates a foreclosure problem in the market for streaming video. From the cable operators' perspective, the most important piece of software running on the customer's equipment is the software to provide "streaming video." At the other end of the cable, customers are linked to local caching servers. These servers store and deliver frequently-used data so as to reduce traffic loads throughout higher levels of the Internet. Residing on the server at the cable head-end, streaming-video software retrieves from the originator a digitally encoded video file, then passes it through, in real time or delayed, to one or more customers as requested.

There are two major competitors in the market for streaming video software: RealNetworks and Microsoft. Other firms, in the Sun/Java family of providers, are potential

¹⁴³ See John Borland, *GTE, AOL Unveil Cable ISP Trials*, CNET News.com (Jun. 14, 1999) <<http://www.news.com/News/Item/0,4,37788,00.html>>.

¹⁴⁴ According to GTE, the companies were able to install this capability in a geographic area serving 80,000 potential customers with "a single one-time investment of \$60,000." GTE News Release, *GTE Demonstrates Ease of Cable Open Access to Multiple ISPs; Clearwater Trial Shows One-Time Investment of Less Than \$1 Per Home Would Provide Consumer Choice* (June 14, 1999).

entrants. RealNetworks is strongly dominant. The providers of this software sell nationally to firms wanting to install the software on their local servers.

@Home has signed an exclusive contract for such software with RealNetworks.¹⁴⁵ In what @Home describes as an "exclusive development effort[]," RealNetworks will deploy RealSystem's G2 delivery platform on @Home's network servers.¹⁴⁶ This will allow @Home to cache video and audio content on its own network rather than on an end user's PC.¹⁴⁷ This arrangement gives @Home the ability to favor its preferred content providers.¹⁴⁸ These providers

¹⁴⁵ A recent investment report noted that "more than 85 percent of all video and audio content streamed across the Internet is in RealNetworks' format." J.F. Powers, BancBoston Robertson Stephens, Investext Rpt. No. 2727489, RealNetworks — Company Report, at *1 (Jan. 8, 1999).

¹⁴⁶ @Home, *RealNetworks Team Up on Broadband Streaming Media Delivery Platform*, EDP Weekly's IT Monitor, Jan. 18, 1999, at 1. @Home gives preferential treatment to the more than 100 companies in its Media Development Program by replicating and caching their content and applications on these servers. Excite@Home, *Frequently Asked Questions*, <<http://www.home.com/qa.html>>; Excite@Home, *Network Architecture*, <<http://www.home.net/about/network.html>>; AtHome, 1999 Form 10-Q, *supra*, note 61; AtHome Corp., Form 10-K405 (SEC filed Feb. 19, 1999). These companies include: Amazon.com, Associated Press, CBS SportsLine, Segasoft, and Yahoo!. @Home, *The @Home Advantage* <<http://www.home.net/about/advantage/experience.html>>; @Home, *Shopping* <<http://www.home.com/shopping.html>>; @Home, *News* <<http://www.home.com/news.html>>; @Home, *Technology* <<http://www.home.com/tech.html>>; @Home, *Sports* <<http://www.home.com/sports.html>>; @Home, *Games* <<http://www.home.com/games.html>>; @Home, *Search* <<http://www.home.com/navigation.html>>; @Home, *Network Architecture* <<http://www.home.net/about/network.html>>.

¹⁴⁷ Raj Kapoor, @Home's director of applications and e-commerce, explained, "We can pull one stream and using RealNetworks' technology replicate the stream at the head-end." Jay Sherman, @Home, *RealNets Try to Get Up to Speed on Video*, Hollywood Rep., Jan. 20, 1999, at 8.

¹⁴⁸ See Lessig, *supra* note 122 ("The network is being designed to restrict ISP choice, and thereby lock broadband customers to the cable operator's local broadband network. . . . [L]ocal caching will mean content on the local cable network will flow faster. The cable network will become a premium IP network; AT&T will collect the premium.").

will only need to send @Home one copy of a live stream or clip which will then be replicated on the @Home network using the G2 platform.¹⁴⁹ "This technology will have the ability to block certain things if affiliates find[] that there's an issue with encroachment on their business," said Raj Kapoor, @Home director of applications and e-commerce.¹⁵⁰

The foreclosure in this market derives from the fact that AT&T-controlled @Home has entered into an exclusive arrangement with RealNetworks. Assuming that AT&T has RealNetworks serve MediaOne's customers upon completion of the merger, then AT&T/RealNetwork's 40-percent share of customers jumps immediately to 57 percent.¹⁵¹ For rival sellers of video streaming software, this level of foreclosure is substantial.

The share of this market that the merger would give AT&T is even more problematic given both its ability and incentive to slow down the development of the video-streaming market itself. As streaming video and cable television begin to compete, AT&T has an incentive to slow innovations in streaming video software so as to minimize the "cannibalizing" of its more profitable cable-video subscribers.¹⁵² Already, customers of AT&T's broadband network are not

¹⁴⁹ *@Home Network and RealNetworks Team to Create Next Generation Broadband Streaming Media Delivery Platform*, PR Newswire, Jan. 15, 1999.

¹⁵⁰ Dawson, *supra* note 46, at 2. At a recent gathering of the cable industry in Chicago, Cisco Systems, the No. 1 provider of data network equipment, circulated a marketing brochure in which it explained how a cable company could block access to certain Web sites and how it could give preferential treatment to certain types of traffic flowing across a network. See Ben Heskett, *Cisco Drawn into Net Control Battle*, CNET News.com (July 30, 1999) <<http://www.news.com/News/Item/0,4,39979,00.html>>.

¹⁵¹ See *supra* note 139 and accompanying text.

¹⁵² The Department of Justice and the Federal Trade Commission have expressed particular concern in recent years about mergers that would stunt innovation. See, e.g., *Intellectual Property Guidelines* § 3.2 (1995); Varney, *Innovation Markets in Merger Review*

permitted to download more than 10 minutes of streaming video.¹⁵³ AT&T will likely find it advantageous to exert its market power in the streaming video market through incompatible designs and exclusive contracts.

A comparable anticompetitive harm would be inflicted by the proposed merger on the programming side. AT&T and @Home are entering into contracts by which AT&T sells exclusive access, or preferential positions, to favored online content providers. For example, earlier this year, AT&T signed a five-year deal with Fox News for “premier placement” on the @Home news channel.¹⁵⁴ AT&T’s choice of a preferred content provider is enforceable on all @Home partners. The proposed merger would allow AT&T to proliferate this foreclosure or disadvantaging of disfavored content providers through its direct or indirect control of transport access and portal access to 80% of residential broadband customers. It is not in the public interest for the Commission to bless creation of such a bottleneck.

C. The Market for IP Telephony

Internet Protocol (IP) telephony enables customers to use Internet connections to carry two-way voice communications. With traditional low-speed transmissions, IP telephony is too poor in quality to substitute for traditional telephony. Using broadband transport like cable lines, however, the quality improves dramatically, costs diminish, and a very wide range of new

Analysis, 9 Antitrust 16 (Summer 1995); *United States v. General Motors Corp.*, Civ. No. 93-530 (D. Del. Nov. 16, 1993).

¹⁵³ Dawson, *supra* note 46, at 2.

¹⁵⁴ See *Fox is At Home in Broadband*, *supra* note 60.

functionality not available through circuit-switched telephony becomes possible as well — *e.g.*, fully integrated voice-video services.

AT&T's plan is to serve its voice customers through IP telephony.¹⁵⁵ AT&T in fact intends to be the exclusive provider of IP telephony to all broadband customers under its control. AT&T's plan therefore greatly diminishes the competitive benefits that IP telephony over cable wires might otherwise bring, by limiting the number of viable IP telephony providers to one, itself. Because this merger would compound AT&T's stranglehold over broadband customers, it would decrease competition in the market for IP telephony even further.

AT&T's long-term plans are to achieve even greater dominance in this market, and the MediaOne merger would only expedite this. AT&T has already announced deals — whose final inking awaits the MediaOne acquisition — to be the exclusive IP-telephony provider for Time Warner's and Comcast's broadband customers. AT&T's deal with Time Warner would give AT&T exclusive rights to provide cable telephony to residential and small business customers over Time Warner's networks — networks that pass nearly 20 million homes, mainly in major urban markets, in 33 states.¹⁵⁶ AT&T's deal with Comcast would give AT&T the exclusive right

¹⁵⁵ According to AT&T's Chairman, "analysts should think of IP as 'cost-reduction plan,' making areas more efficient as it becomes available: 'As IP proves itself, we'll integrate it.' Real marketing of IP telephony could come next year, Armstrong said." *MediaOne Seen To Give AT&T National Scope for Local Telephony*, Comm. Daily, Apr. 26, 1999; C. Leifur, U.S. Bancorp Piper Jaffray Inc., Investext Rpt. No. 2872177, Telecom Equip.: Network Infrastructure Monthly, at *14 (June 1, 1999) ("AT&T has expressed a desire to migrate to IP-based telephony over time, but we think it will be at least 18 months to 24 months before IP telephony meets AT&T's quality requirements.").

¹⁵⁶ Under the agreement, AT&T would own 77.5 percent of the joint venture, and Time Warner would own 22.5 percent. "The two companies expect to pilot the service in one or two cities by the end of 1999 and to begin broader commercial operations in the year 2000." AT&T News Release, *AT&T and Time Warner Form Strategic Relationship to Offer Cable Telephony*

to provide IP telephony to an additional 8.6 million homes.¹⁵⁷ In the case of Time Warner, the contract is — astonishingly in this rapidly changing industry — for 20 years.¹⁵⁸

Finally, permitting AT&T to increase its control over the IP-telephony market would likely have anticompetitive effects in the long-distance market as well. IP telephony is, in fact, an even more attractive substitute for long-distance service than for local service, which, for wireline service, still requires a much greater degree of dedication of particular facilities to each customer. With its deals with Time Warner and Comcast, AT&T's share of the IP Telephony market is already about 42 percent; if it merges with MediaOne, AT&T's share will grow to approximately 59 percent.¹⁵⁹

(Feb. 1, 1999).

¹⁵⁷ AT&T will transfer systems with 1.2 million homes passed (735,000 subscribers) to Comcast on completion of the MediaOne merger. AT&T has counted this reduction in its license transfer application with the FCC and notes that Comcast has an option to purchase additional systems. AT&T/MediaOne Application, app. A, at 1 n.3. Comcast previously had 7.4 million homes passed. Comcast Cable Communications, Inc., 1998 Form 10-K, at 1 (SEC filed Mar. 19, 1999). The additional systems on which Comcast has an option would raise Comcast's totals to 7.3 million subscribers and 10.7 million homes passed.

¹⁵⁸ *AT&T, Time Warner Set Phone-Cable-TV Service*, TechWeb (Feb. 1, 1999) <<http://www.techweb.com/wire/story/reuters/REU19990201S0001>>.

¹⁵⁹ These percentages are based on the cable-modem subscribers in AT&T/TCI's network (52,000 or 8 percent of all broadband Internet subscribers), Comcast (72,000 or 11 percent), and Time Warner (148,000 or 23 percent), giving a current total of 272,000 or 42 percent. With the addition of MediaOne subscribers (109,000 or 17 percent), the total after the merger will be approximately 381,000 or 59 percent of United States broadband market. *See supra* note 117.

D. The Market for Broadband Equipment and Software

The proposed merger's concentration of control of broadband inputs also would have anticompetitive effects in markets for broadband equipment and software. The Commission has recognized that cable modems and set-top boxes, like customer premises equipment in the telephone market, are products separate and apart from the distribution of content over the wires.¹⁶⁰ The fact that @Home and Road Runner require their customers to lease cable modem equipment from them clearly amounts to a condition to purchase the tied product (the cable modem) if the customer chooses to purchase the tying product (broadband Internet access over cable).

General Instruments currently has a significant share of the market for cable CPE. The total number of subscribers of cable companies with General Instruments equipment contracts is 47.1 million (71 percent of U.S. subscribers); the total number of homes passed by cable companies with General Instruments equipment contracts is 73.6 million (77 percent of homes passed).¹⁶¹ To the extent that AT&T controls the equipment that users of @Home purchase, it

¹⁶⁰ See Report and Order, *Implementation of Section 304 of the Telecommunications Act of 1996; Commercial Availability of Navigation Devices*, 13 FCC Rcd 14,775 (1998) ("Section 629 Order").

¹⁶¹ General Instruments' principal customers are: TCI; Time Warner; MediaOne; Comcast; Cox Communications; Adelphia Communications; Shaw Communications; Jones intercable; Charter Communications; Lenfest Group; InterMedia Partners and Bresnan Communications. According to Paul Kagan Associates, Probe Research, Allied Business Intelligence, and General Instruments estimates, General Instruments is the market leader in digital systems (85-percent to 90-percent market share), analog addressable systems (60-percent to 64-percent market share), wireless addressable systems (68-percent to 72-percent market share), RF distribution systems (29-percent to 31-percent market share), and fiber optics (33-percent to 35-percent market share) and has the second-largest market share in total head ends installed (analog and digital) with a 24-percent to 26-percent market share and digital satellite receivers with a 30-percent to 31-percent market share. The same report also lists General

will direct such purchases to the company in which it has a financial interest (General Instruments). The effect on the cable-equipment market could be devastating.

Furthermore, Microsoft may well emerge as AT&T's preferred end-user software vendor. The vast majority of users already access the Internet through a machine that runs a Microsoft operating system, and a rapidly growing fraction now use Microsoft's browser.¹⁶² Microsoft owns a significant block of equity in one of @Home's own partners¹⁶³ and has tried once before to buy a stake in @Home itself.¹⁶⁴ As a result of its recent partnership agreement with AT&T, Microsoft will have access to as many as 10 million set-top boxes.¹⁶⁵ Before the AT&T/Microsoft agreement, @Home had no trouble declining to designate Microsoft as its

Instruments as the worldwide market leader (60-percent market share) in addressable systems (analog and digital set-top boxes) with 2400 systems and 40 million set-top boxes installed.

¹⁶² Road Runner customers use a customized version of Microsoft's Internet browser to navigate the Internet. Road Runner Press Release, *Time Warner's Road Runner Launches in Akron/Canton Area* (Sept. 10, 1996); Road Runner Press Release, *Road Runner Selects Microsoft Internet Explorer 4.0* (Sept. 18, 1997).

¹⁶³ On June 9, 1997, Microsoft invested \$1 billion in Comcast Corporation. See Comcast News Release, *Microsoft Invests \$1 Billion In Comcast Corporation*, June 9, 1997. This gave Microsoft an 11-percent interest in Comcast. See Jay Greene, *Microsoft May Invest \$5 Billion In AT&T For Next-Generation TV -- Deal Could Be Announced Tomorrow*, Seattle Times, May 5, 1999, at A1.

¹⁶⁴ John M. Higgins, *Microsoft Chasing Road Runner*, Broadcasting & Cable, May 18, 1998, at 5.

¹⁶⁵ Steve Lohr, *In AT&T Deal, Microsoft Buys Stake in Future of Cable TV*, N.Y. Times, May 7, 1999, at C1. "[N]ow that they have cornered the network, . . . they are putting the network under lock and key by putting Microsoft technology inside the set-top box." Seth Schiesel, *Concerns are Raised as AT&T Strikes Deal with Microsoft*, N.Y. Times, May 6, 1999, at A1.

preferred provider of software.¹⁶⁶ Windows was used on only a portion of @Home's set-tops; @Home used software from other vendors, such as Sun Microsystems, to provide an interface with their high-speed Internet service.¹⁶⁷ TCI likewise bypassed Microsoft when it contracted with Sun Microsystems for the PersonalJava communications platform to be placed on 18 million set-top boxes.¹⁶⁸

The partnership between AT&T, which is now the overwhelmingly dominant force in the cable industry, and Microsoft, which is already the overwhelmingly dominant force in the software industry, already threatens to determine how the next generation of Internet-access software will evolve on the customer premises, on what timetable, and at what price. The present merger, by concentrating cable control even further, would significantly add to that

¹⁶⁶ See, e.g., R. Bilotti et al., Morgan Stanley, Dean Witter, Investext Rpt. No. 2564096, Telecommunications Cable T.V. - Industry Report, at *5 (July 7, 1997) ("[T]here has been conjecture that Microsoft will be able to drive development of digital set-tops and high-speed cable modems."). See also M. A. McCaffrey et al., Alex Brown & Sons, Investext Rpt. No. 1677087, Microsoft Corporation — Company Report, at *2 (Dec. 12, 1995); M. B. Soper, Bear Stearns & Co., Inc., Investext Rpt. No. 2635535, High Grade Research/Telecom/Cable/ Media — Industry Report, at *1 (Nov. 5, 1997); M. Hassenberg et al., Donaldson, Lufkin & Jenrette Securities, Investext Rpt. No. 2616098, Cable Equipment Capex Cycle (Transcript) — Industry Report, at *2, *6 (Nov. 10, 1997).

¹⁶⁷ Yoshiko Hara, *Sony, GI Work on Cable-TV Set-Top Box*, Elec. Eng'g Times, Jan. 11, 1999; *Sun Scores Set-Top Win with TCI*, Comm. Today, May 13, 1998.

¹⁶⁸ An e-mail released in the Microsoft antitrust trial recounts a meeting between TCI Chairman John Malone and Bill Gates in May 1996 in which Gates threatened to destroy @Home because of its "anti-Microsoft" stance. Gates "just exploded" at Malone "as part of their scheduled one-on-one meeting, threatening to bury this company, buy cable operators, and do whatever it took to crush At Home, since we are obviously so anti-Microsoft that it's criminal," said the May 24, 1996 e-mail sent by Milo Medin, senior vice president of @Home, to Marc Andreessen, Executive Vice President of Netscape. *E-mail: Gates Vowed to Hurt Rival; Redwood City's At Home Corp. Was Focus of His Wrath, Exec Wrote*, S.F. Examiner, Oct. 28, 1998, at C1.

threat. The two companies could, as a result of this merger, more easily prescribe who will furnish the necessary software and hardware, as well as the features and functions built into both.

IV. AT&T AND MEDIAONE HAVE NOT SHOWN THAT THE MERGER WOULD PROVIDE THE TOUTED BENEFITS FOR LOCAL TELEPHONE USERS

Applicants have repeatedly sought to justify their merger on essentially one ground: that the merger would provide consumers of local telephone service with otherwise-unavailable benefits. Applicants assert that AT&T “has invested tens of billions of dollars of shareholder assets to acquire TCI and modernize its cable network in order to provide residential consumers with local exchange and exchange access services. AT&T’s merger with MediaOne would expand and accelerate these efforts, bringing choice and the benefits of competition to millions more *local telephone customers*.”¹⁶⁹ The principal benefit of the merger, according to the applicants, is that it “will create economies in providing local exchange services in competition with ILECs.”¹⁷⁰ This is the heart of the application.

The Commission should not be fooled by or relax the careful guard it has maintained against such claims. For one thing, this assertion could not justify disregarding the numerous legal violations and serious anticompetitive harms that would result from the merger as proposed. In addition, however, the claim of benefits — which must derive from the merger to count — is so unworthy of being credited as to be entitled to little (if any) weight in applying the public-interest standard.

¹⁶⁹ AT&T/MediaOne Application at 20 (emphasis added).

¹⁷⁰ *Id.* at 27.

First, it is simply not credible that, unless they could merge, AT&T and MediaOne would drop or substantially curtail their efforts, within their own systems, to make the investments needed to use them for telephony. The statement quoted above concerning AT&T's investments in TCI is sufficient to discredit such a claim. So does the evidence of MediaOne's aggressive upgrade efforts. While applicants describe MediaOne's telephony penetration as "low" and its success in signing up customers as "modest,"¹⁷¹ MediaOne has presented a very different picture elsewhere: "In April, Detroit became the latest market to offer digital telephone services, bringing to seven the number of markets in which MediaOne's telephone services are available. *MediaOne is adding telephone customers at an impressive rate*, and now serves nearly 36,000 telephone lines used by 26,000 customers. *That's a 64 percent increase in telephone lines since the end of the first quarter.*"¹⁷² And the Commission has already singled out MediaOne, contrasting it with TCI, as a "most significant market participant," noting that MediaOne already was providing local exchange service in parts of Atlanta, Boston, Jacksonville, Pompano, and Richmond.¹⁷³

Current marketplace dynamics, by applicants' own view, also make implausible any claim of materially dampened investment without the merger. Upgrading to provide broadband services is an imperative with DSL's emergence, even considering the regulatory limitations placed on DSL. Similarly, the entry of the Bell companies into long distance, now imminent, has

¹⁷¹ AT&T/MediaOne Application at 23.

¹⁷² MediaOne 1999 Second Quarter Earnings Press Release, *MediaOne Group Operating Cash Flow Up 15 Percent* (July 27, 1999) (emphasis added).

¹⁷³ *AT&T/TCI Order*, 14 FCC Rcd at 3185 & n.155 [¶ 47].

long been understood to be the essential prod to AT&T's taking the steps needed to offer, at least to the profitable customers, local telephone service. Applicants' "threat" to pull back on their investments, in short, is not credible.

Indeed, applicants' contention depends on the claim that, to encourage their investment, they require the extra profits that would come from their tying arrangements with @Home and Road Runner. Yet, elsewhere, the law has disallowed claims to such profits as a necessary incentive to spur investment.¹⁷⁴ Even without any demand for tying-based leverage profits, the Commission turned aside the incumbent LECs' "incentive-to-invest" argument against compelled unbundling of DSL services, when the incumbent LECs were seeking nothing more than to keep a product they developed to themselves.¹⁷⁵ The Commission certainly cannot accept the argument made by applicants here.

Second, and in any event, applicants' references to benefits for local telephone customers is fundamentally misleading. AT&T shows no signs of being interested in becoming a local telephone company in competition with incumbent LECs offering plain old telephone service ("POTS") unbundled from other services that higher-volume users are most likely to purchase,

¹⁷⁴ In patent law, for example, where a monopoly right is granted for the purpose of encouraging investment in new inventions, tying non-patented products to the patented one has always been forbidden: the extra profits are not part of the authorized incentive. *See Eastman Kodak*, 504 U.S. at 479 n.29. *See also Eastman Kodak* on the antitrust standards proscribing tie-in arrangements.

¹⁷⁵ *See Memorandum Opinion and Order, and Notice of Proposed Rulemaking, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 13 FCC Rcd 24,011, 24,048 [¶ 79] (1998) ("to the extent that advanced services are offered by an incumbent LEC, we find, on the record before us, that it is consistent with the public interest to subject such incumbents to full incumbent LEC regulation").

including long-distance, wireless, video programming, broadband Internet access, and IP telephony.¹⁷⁶

The merger as proposed cannot be approved on the theory that AT&T intends to compete in the market for local residential telephone service. Applicants' practices and announcements indicate that they will not be offering unbundled local telephone service. They have made no enforceable commitment to do so. As proposed, the merger would not provide, for a wide swath of local telephone customers, the central benefit that applicants so loudly tout. Unless compelled to offer service on terms that are actually competitive with comparable services offered by incumbent LECs, the promoted benefit is nonexistent where it is most needed.

In an analogous context, the Court of Appeals for the Fifth Circuit recently recognized that a firm offering only a high-priced bundle of services is not, in fact, satisfying its universal-service obligation to offer POTS. In *Texas Office of Public Utility Counsel v. FCC*, the Court of Appeals found that eligible telecommunications carriers receiving universal service support must "maintain[] affordable service in a competitive local market."¹⁷⁷ But "[a]llowing bundling, however, would completely undermine [this] goal . . . because a carrier could qualify for universal service support by simply offering and then advertising expensive, bundled services to

¹⁷⁶ According to AT&T's President John Zeglis, "our brand is trusted by about 50% more than the next brand to deliver a product bundle." Toni Mack, *Wireless Warrior*, *Forbes*, Apr. 19, 1999, at 190. "Through its own systems and in partnership with affiliates, AT&T Consumer Services will bring to people's homes the first fully integrated package of communications, electronic commerce and video entertainment services." AT&T Press Release, *AT&T, TCI To Merge, Create New AT&T Consumer Services Unit* (June 24, 1998).

¹⁷⁷ *Texas Office of Pub. Util. Counsel v. FCC*, No. 97-60421, 1999 U.S. App. LEXIS 17941, at *47 (5th Cir. July 30, 1999).

low-income customers who cannot afford it.”¹⁷⁸ And that is precisely what AT&T/MediaOne’s anticipated offering of its bundle of services would do. AT&T will not meaningfully contribute to competition for the very class of customers — mass-market, residential consumers, with relatively low usage of non-local services — that have been of most concern to the Commission. AT&T’s assertion that its merger with MediaOne will add to “local telephone competition” is thus insincere in its most important application.

In its recent decision, the Fifth Circuit upheld the Commission’s decision not to require unbundling as a general matter because the court believed that the Commission would insist on the *actual* availability of service to all customers.¹⁷⁹ In the present context, the Commission must insist on a similar condition as the minimum necessary before giving any weight to AT&T’s claim that the merger will contribute to “local telephone competition.” At a minimum, the Commission must demand of AT&T/MediaOne a commitment to provide local telephone service, unbundled from its other high-priced telecommunications services. Without such a specific condition requiring the combined AT&T/MediaOne actually to make local-only telephone service available, applicants simply have not met their burden of demonstrating even the benefits they claim.

CONCLUSION

The proposed merger would violate statutes and rules that the Commission may not turn off for this special case. Indeed, the proposed merger would produce anticompetitive harms not only in traditional cable markets, but also in the increasingly important broadband markets,

¹⁷⁸ *Id.*

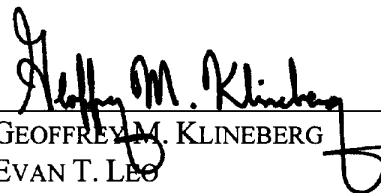
¹⁷⁹ *Id.* at *48 (the Commission “reasons that if offering only bundled services would price low-income customers out of the market, the carrier offering bundled services would eventually lose universal service support”).

where the merger would place AT&T in an extraordinary position of bottleneck control. No significant weight can be given to the implausible, misleading, and insufficient claims of benefits from the merger. The merger should be disapproved altogether.

Even conditions, like severing the coerced tie of broadband transport to broadband content (*i.e.*, guaranteeing open access to competitors of @Home and Road Runner) and requiring unbundling of local services, cannot save this merger. But, at a minimum, they should be explored as necessary conditions. At present, the Commission must require applicants to provide much more detailed information about critical matters, including system-by-system programming interests and plans for adjacent-market competition, than they have yet done.

For the foregoing reasons, Bell Atlantic's petition to deny the application should be GRANTED and the joint application to transfer certain licenses and authorizations submitted by AT&T and MediaOne should be DENIED.

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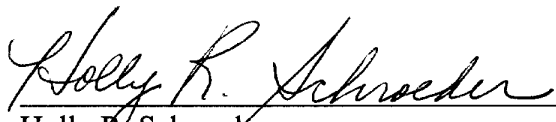
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August 23, 1999

CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of August 1999, I caused copies of Bell Atlantic Corporation's Petition to Deny the Application to be served upon the following parties by either first-class mail, postage prepaid, or hand delivery as indicated by an asterisk (*).


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